



In the Supreme Court

OF THE
United States

OCTOBER TERM, 1973

No. 73-5265

Supreme Court, U. S.
FILED

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HENRY A. KOKOSZKA, Bankrupt, *Petitioner*,

VS.

RICHARD BELFORD, Trustee in Bankruptcy of the Estate
of Henry A. Kokoszka, Bankrupt, *Respondent*.

BRIEF OF AMICI CURIAE THE LEGAL AID SOCIETY OF
SAN MATEO COUNTY, CALIFORNIA, AND HANSEN,
JAFFE & WEISS, ATTORNEYS AT LAW
IN SUPPORT OF
THE PETITION FOR WRIT OF CERTIORARI

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PETITION NOT PRINTED
RESPONSE NOT PRINTED

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I

INTEREST OF THE AMICI CURIAE*

The Legal Aid Society of San Mateo County is an OEO funded legal services program providing civil representation of poor persons in San Mateo County,

*Letters of consent from the petitioner and respondent to the filing of this brief pursuant to Rule 42(1) have been filed with the Clerk.

California. From its inception the Legal Aid Society has represented a substantial number of bankrupts and on account of that representation has a continuing interest in the administration of the Bankruptcy Courts.

Hansen, Jaffe & Weiss is a private law partnership specializing in the representation of wage earner bankrupts both for personal bankruptcies and for Chapter XIII arrangements. Thus Hansen, Jaffe & Weiss also has an ongoing interest in the administration of the Bankruptcy Courts.

Additionally, both the Legal Aid Society of San Mateo County and John Hansen and Michael Weiss of Hansen, Jaffe & Weiss represented the bankrupts in *Lines v. Frederick*, 400 U.S. 18 (1970), and in *Riggs v. James*, 470 F.2d 996 (C.A. 9 1972). In the case which is the subject of this brief, the United States Court of Appeals for the Second Circuit narrowly construed *Lines v. Frederick*, supra, and explicitly refused to follow *Riggs v. James*, supra.

II

ARGUMENT

A. INTRODUCTION

This case involves the question whether a refund owing to a bankrupt as the result of wage withholdings in excess of his or her tax liability should be treated as an asset of the bankrupt's estate.

The Court of Appeals for the Second Circuit, in the judgment entered hereinbelow, and the Ninth Cir-

cuit, in *Riggs v. James*, 470 F.2d 996 (C.A. 9 1972), cert. denied, 410 U.S. ____ (1973), have reached exactly opposite and conflicting conclusions with respect to this question.

The *Amici Curiae* herewith contend that the Ninth Circuit, in holding that such refunds are not to be treated as administratable assets, reached the correct conclusion, and that under the well-established "fresh start" doctrine a wage earner bankrupt should be entitled to retain and use such refunds received subsequent to filing bankruptcy.

B. THE TRADITIONAL VIEW OF BANKRUPTCY ADMINISTRATION SUPPORTS THE NINTH CIRCUIT'S CONCLUSION.

The administration of bankruptcy laws in non-business cases traditionally has been caught between the competing claims of creditors for the bankrupts' assets and of bankrupts' need for relief from the oppression of past debt. Thus, this Court has stated that the act of bankruptcy draws a "line of cleavage" across the bankrupts' life in an effort to resolve this conflict. ~~*Everett v. Jordan*~~ *Andrews v. Partridge*, 228 U.S. 474, 479 (1913). On the past side of the line the debtors' debts are discharged and his non-exempt assets mustered for his creditors. On the future side of the line the bankrupt gets a fresh start so that he may be a productive member of society and accumulate new assets without fear that they will be seized by his creditors. The latter consideration has become known as the "fresh start" doctrine. It has been stated and re-

affirmed by this Court time and again for almost a hundred years. *Neal v. Clark*, 95 U.S. 704, 709 (1877) (Opinion by Mr. Justice Harlan); *Traer v. Clews*, 115 U.S. 528, 541 (1885); *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904); *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913); ~~*Sweet v. Jordan*~~ *Andrews v. Partridge*, supra; *Williams v. U. S. Fidelity and Guaranty Co.*, 236 U.S. 549, 554-55 (1915); *Stillwagen v. Clum*, 245 U.S. 605, 617 (1918); *Local Loan v. Hunt*, 292 U.S. 234, 244-45 (1934); *Lines v. Frederick*, 400 U.S. 18 (1970).

As the present case herein, this doctrine has been applied to personal bankruptcies. In *Local Loan v. Hunt*, supra, for example, the trustee attempted to use an Illinois wage lien law to reach across the "line of cleavage" to obtain for the creditors a bankrupt's wages after bankruptcy. Based on the "fresh start" doctrine, the Court held that in spite of the wage lien law the debtor's wages were his own after bankruptcy.

The more recent case of *Segal v. Rochelle*, 382 U.S. 375 (1966), however, presented unusual difficulties with respect to the application of the "fresh start" doctrine. In that case the trustee desired to reach forward across the imaginary "line of cleavage" to obtain a loss-carryback tax refund of a business bankrupt. Two circuit courts had ruled that the trustee could not reach such an asset. *In re Sussman*, 289 F.2d 76 (C.A. 3 1961); *Fournier v. Rosenblum*, 318 F.2d 525 (C.A. 1 1963). This Court acknowledged the difficulties *Segal* presented, *Segal* supra at 379, but noted that the case was different because a business bankruptcy was under consideration and because

of the peculiar nature of a loss carryback refund. Even with these critical distinctions, the Court conceded that *Segal* presented a close question. *Id.* at 378. Furthermore, as the Court emphasized in a later case, the "fresh start" doctrine was particularly inappropriate in *Segal* since the business had ceased to operate. *Lines v. Frederick*, 400 U.S. 18, at 20 *supra*.

Thus, *Segal* appears as an exceptional case along the landscape of the "fresh start" doctrine. The traditional approach emerged again in *Lines v. Frederick*, *supra*, where the Court held that the "fresh start" doctrine applied to prevent the trustee from reaching a wage earner bankrupt's accrued vacation pay.

In *Lines*, the same elements which had always before been important for application of the fresh start doctrine were present. The bankrupt was a wage earner. 400 U.S. at 18. The property in question was part of the bankrupt's wages. *Id.* at 20. The bankrupt's rights to his vacation pay arose after the date of bankruptcy, *Id.* at 18; see also, *Frederick v. Lines*, 425 F.2d 215, 216 (1970). Furthermore, in *Frederick v. Lines*, *supra*, the Ninth Circuit noted that its ruling would have little, if any, effect on creditors. *Id.* at 217.¹

Because this case presents the issue of a refund derived from wages withheld for tax purposes, it superficially seems to have elements of both *Segal* and *Lines*. Nevertheless, District Judge Wollenberg in

¹In fact in most non-business bankruptcies there are insufficient assets to pay any dividend to creditors. See e.g., J. Lee, *Book Review*, 46 AM. BANKR. L. J. 159, 161 (1972); J. Dilenschneider, *Dischargeability, etc.*, 44 REF. J. 83, n.2 (1970).

In re Cedor, 337 F.Supp. 1103 (N.D. Cal. 1972), demonstrated that upon close analysis the similarities to *Segal* are illusory.

"Here the Court is confronted with elements of both *Segal* and *Lines*. The funds are received as a tax refund, but the refund is generated by the provisions of the Internal Revenue Code requiring certain amounts to be withheld from wages under *given* circumstances. In *Segal* the refund amounted to the recovery of a part of the taxes paid on profits in earlier years because of losses in the operation of a business in the taxable year; these losses also were a precipitating cause of the bankruptcy. In the instant cases, the Court is concerned with the refund of what was, in effect, a *forced* overpayment of tax on wages. There is nothing to suggest that the sums refunded were related to the circumstances which precipitated the bankruptcy. The Supreme Court considered the question in *Segal* to be 'close', 382 U.S. 379, 86 S.Ct. 511, 15 L.Ed. 2d 428; in light of *Lines* and *Snaidach* [sic], the balance on this question tips in favor of the bankrupt. The collection by the Internal Revenue Service without the consent or control of the bankrupt, and the belated refund, render these funds quite similar in a practical sense, to the accrued but unpaid wages which constituted vacation pay. If *Lines* stands for anything, it is that the practical realities are controlling in this determination." *In re Cedor*, 337 F.Supp. at 1105, *supra*.

In contrast the Second Circuit below stated:

"What we have then in *Lines* is a very narrow exception to the general proposition that

everything of value passes to the trustee, i.e., vacation pay which will become essential for basic week to week support in the future does not pass. Because a tax refund is not the weekly or other periodic income required by a wage earner for his basic support, to deprive him of it will not hinder his ability to make a *fresh* start unhampered by the pressure of existing debt." *In re Kokoszka* _____ F.2d _____ (C.A. 2 1973) (Slip Opinion p. 3674) [emphasis in the original].

The Second Circuit's analysis, unlike Judge Woltenberg's which the Ninth Circuit adopted, is based on false premises, i.e., that *Lines* is an exceptional case. In fact, exactly the opposite is true: *Segal* is the exceptional case. The *Kokoszka* court cited no authority for its proposition that only property in the nature of periodic support is protected by the "fresh start" doctrine. Furthermore, to the extent the court's statement depends on factual matters in the record, it is erroneous. The record clearly shows that Kokoszka's tax refund check was necessary for his support. *In re Kokoszka*, _____ F.2d _____ (C.A. 2 1973) (Slip Opinion p. 3674). The *Kokoszka* court also failed to carefully analyze the "fresh start" doctrine in bankruptcy law. Its opinion permits a trustee to reach beyond the "line of cleavage" to seize a future refund derived from wages so that it may be applied to the burden of past debt. The *Kokoszka* court thus reached its conclusion without showing that any of the exceptional elements of *Segal* were present, contrary to the teaching of *Lines v. Frederick*, 400 U.S. 18, *supra*, as will be demonstrated below.

C. THE OPINION BELOW IS INCONSISTENT WITH LINES v. FREDERICK AND OTHER DECISIONS OF THIS COURT REGARDING A PERSON'S WAGES.

As discussed above, the result reached in *Riggs v. James*, supra, and *In re Cedor*, supra, reflected the important fact that the refunds in question represented the earnings of the bankrupts. *In re Cedor*, supra at 1105. In this regard the courts relied upon legal doctrines going back almost a hundred years. In *Traer v. Clews*, supra at 541, this Court said:

"The policy of the bankrupt act was, after taking from the bankrupt all his property not exempt by law, to discharge from his debts and liabilities and enable him to take a fresh start. *His subsequent earnings were his own.*" [Emphasis added.]

The same important concept was reiterated in *Local Loan v. Hunt*, supra at 245.

"The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much if not more than it is a property right."

This important concept was cited and relied upon in *Lines v. Frederick*, supra at 20. Nevertheless, the *Kokoszka* court erroneously suggests that *Lines* is out of the mainstream of decisional law and should not be relied upon to support the proposition urged herein. Moreover, *Lines* is also consistent with a number of recently decided and related non-bankruptcy decisions, which have considered the rights of wage earners. In each case, without exception, this Court

has protected the rights of the wage earner against the claims of the creditors.

The leading case is *Sniadach v. Family Finance Co.*, 395 U.S. 337 (1969)², which held that a person's wages may not be garnished without prior notice and hearing. *Sniadach* was followed by and cited as authority in *Lines* the following Term. 400 U.S. at 20. *Sniadach* and *Lines* were followed in a further series of cases favorable to wage earners. *E.g.*, *James v. Strange*, 407 U.S. 128 (1972) [anti-exemption statute as to class of debtors held unconstitutional under 14th Amendment Equal Protection Clause]; *Fuentes v. Shevin*, 497 U.S. 67 (1972) [*Sniadach* applied to personal property as well as wages]; *Lynch v. Household Finance Co.*, 405 U.S. 538 (1972) [a person's right to enjoy and preserve property and wages is a basic civil right].

Consequently, the reliance of the Ninth Circuit in *Riggs v. James*, *supra*, upon *Lines v. Frederick*, *supra*, was not misplaced. Rather, *Lines*, a significant mainstream decision, is extremely apposite. This conclusion has been supported by the statement of one of the leading authorities on consumer bankruptcy law that the *Cedor* court's "extension of *Lines* does seem logical." Countryman, *The Use of State Law in Bankruptcy Cases I*, 47 N.Y.U. L. REV. 407, 461 (June 1972).

²Critics of *Sniadach* also have tried to characterize it as an aberrational decision; but in *Fuentes v. Shevin*, 407 U.S. 67, 88 (1972), the Court took pains to point out that *Sniadach* is in the mainstream of its decisions.

Furthermore, the *Kokoszka* court's argument that property having its source in wages does not deserve special protection (Slip Opinion p. 3674) misconceives the case. At issue herein is not property purchased by wages or wages that have been otherwise disposed of; rather, the refund check is simply a return to the bankrupt of a forced overpayment of wages. *In re Cedor*, supra at 1105. Additionally both the factual record herein and reference to outside sources³ demonstrates that the return of wages as a tax refund check is as necessary for the support of the bankrupt as his periodic wages or his vacation pay. Petitioner Kokoszka required his tax refund for otherwise deferred, but necessary medical expenses. *In re Kokoszka*, _____ F.2d _____ (C.A. 2 1973) (Slip Opinion p. 3674). Additionally as Mr. Justice Powell stated, speaking for a unanimous court in *James v. Strange*, 407 U.S. 128, 135:

"The debtor's wages are his sustenance, with which he supports himself and his family. The average low income wage earner spends nearly nine-tenths of those wages for items of immediate consumption." [Footnote omitted.]

Such concern for wages seems especially important in the bankruptcy context because a bankrupt necessarily must look to the rewards of his labor for his fresh start.

³See Stanley & Girth, *Bankruptcy: Problem, Process, Reform*, 63 (Brookings Institution 1971).

**D. THE RESULT OF THE HOLDING IN RIGGS v. JAMES
IS NOT UNFAIR TO CREDITORS**

As this Court in *Segal* looked also to the unfairness of depriving creditors of a loss-carryback refund, so too the Ninth Circuit in *Frederick v. Lines*, supra, observed that permitting bankrupts to retain their vacation pay will not adversely affect creditors. *Id.* at 217. In fact the Ninth Circuit noted the futility of a system which devours those very assets it was designed to collect when it stated:

“[S]uch funds when, if ever, received by the employee would usually be consumed by the expenses of administration incurred to keep the estate open.”

The Second Circuit also noted the same situation in the opinions below, as follows:

“Clearly the purpose of the Bankruptcy Act was to benefit creditors and debtors not trustees [citations]. Therefore, there is no sense in taking a small sum from the bankrupt debtor, which he could well use.” (Slip Opinion p. 3676).

A study of selected bankruptcies in the Northern District of California showed that the average dividend to unsecured creditors was less than seven-tenths of one per cent of scheduled indebtedness. *Riggs v. James*, supra, (Brief of Appellees, App. A). The same study shows that 64.3% of the assets marshalled went to pay administrative expense. *Id.* A study of eight other bankruptcy courts in the United States shows that 41% of all the assets mustered are consumed by administration, and that

the average dividend to unsecured creditors is 1.8%. D. Stanley and M. Girth, *Bankruptcy: Problem, Process, Reform*, 91 (Brookings Institution 1971).

Against these admittedly serious considerations, the *Kokoszka* court refers the bankrupt to the cumbersome and unlikely procedures of abandonment. Unfortunately such an alternative would only compound the present problem by placing additional burdens on the administration of the Bankruptcy Court, and create even greater lack of uniformity in the administration of the bankruptcy laws contrary to the express desires of the Congress in the Consumer Credit Protection Act. 15 U.S.C. §1671. Instead, it should be established uniformly that not only is a refund of wages from overpayment of taxes necessary for a bankrupt's fresh start, but also the loss of such an asset will rarely harm creditors.

E. THE RESTRICTIONS ON GARNISHMENT OF THE CONSUMER CREDIT PROTECTION ACT APPLY TO ANY PORTION OF THE REFUND CHECK THAT MAY PASS TO THE TRUSTEE.

The District Court in *Cedor* recognized the possibility of creating a forced savings fund through *voluntary* overwithholding and held that refunds attributable to such withholdings should pass to the trustee. The Court held, however, since such refunds are still wage payments that the restrictions on garnishment of the Consumer Credit Protection Act (hereinafter CCPA), 15 U.S.C. §§1671-77 are applicable to them. The Ninth Circuit also affirmed this

portion of the District Court's judgment. The court below, nevertheless, refused to follow that opinion and held to the contrary.

The fundamental provision of the CCPA prohibits garnishment of more than 25% of a person's disposable earnings. 15 U.S.C. §1673(a). Earnings are defined as follows:

"Compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus or otherwise, and includes periodic payments pursuant to a pension or retirement program." 15 U.S.C. §1672(a).

There is no dispute that the refunds here consist entirely of compensation payable for personal services. The fact that in ordinary usage this compensation, when received, may be called a "tax refund check" should not affect its characterization since the Act broadly defines wages no matter how they are denominated. Moreover, the statute makes no distinction or exceptions that derive from the time of receipt; thus more delay in receipt in no way alters the characterization of the payment.

The court below, however, felt that earnings means "periodic payments of compensation." (Slip Opinion p. 3678). While it may be true that Congress could have so defined earnings if it had chosen to do so, a simple reference to the definition quoted above shows that Congress intended to include all "compensation paid or payable for personal services." Additionally, Congress specifically included, as examples of earnings, forms of compensation which are or may be

other than periodic payments such as bonuses and commissions. 15 U.S.C. §1672(a). As Judge Wollenberg succinctly stated in *In re Cedor*, supra at 1107:

"There does not appear to be any reason of policy why the amount of the refund should be held to have lost its character as 'earnings' by reason of its somewhat circuitous route to the wage-earner's hand."

Since, however, the restrictions of the CCPA apply only to disposable earnings, the Court must analyze whether the refund check is disposable earnings. Disposable earnings are defined as follows:

"That part of the earnings of any individual remaining after the deduction from these earnings of any amounts required by law to be withheld." 15 U.S.C. §1672(b).

The question is whether the amount required by law to be withheld is the amount the IRS ultimately withholds for the payment of the employee's tax liability. Such an interpretation appears to be in conformity with the purposes of the CCPA.

The purpose behind the definition of disposable earnings appears to be to permit creditors access to earnings of a wage earner only as they become available to him for spending—in this case when the refund check arrives. It is at this time—when the earnings become disposable—that the restrictions on garnishment apply, and the tax refund check becomes disposable only when received. Thus, the tax refund consists entirely of disposable earnings.

A "garnishment" is defined in the CCPA as:

"[A]ny legal or equitable procedure through which the earnings of any individual are required to be withheld for the payment of any debt." 15 U.S.C. §1672(c).

The court below did not discuss the question of whether a garnishment had occurred in the case before it. However, the court did point out that on February 3, 1972, the bankruptcy Referee ordered Kokoszka to turn over to the trustee his 1971 tax refund check. *In re Kokoszka*, supra (Slip Opinion p. 3670).

There is no dispute here that the bankrupt's tax refund checks derived entirely from their earnings. Nor is there any dispute that these earnings are taken for payment of the debts listed in bankruptcy. Nor can it be disputed that the congressional definition of garnishment is broad and liberal. Nor can it be disputed that these refund checks are being withheld pursuant to the orders of the Bankruptcy Court. The orders of the Bankruptcy Court constitute "legal or equitable procedures" and thus a garnishment has occurred, and the restrictions of the CCPA should apply.

Finally, the Second Circuit's interpretation of this remedial statute is narrow and restrictive, contrary to accepted canons of construction. The court in *Cedor* correctly held that a remedial statute should be construed so as to carry out its intended purpose, rather than in a manner that frustrates that purpose. *In re Cedor*, 337 F.Supp. at 1107, supra. Under the rule

below the bankrupt loses entirely the exemption for a portion of his wages simply because its receipt by him was involuntarily postponed.

F. SUMMARY REVERSAL OF THE DECISION BELOW WOULD AID IN OBTAINING UNIFORM ADMINISTRATION OF BANKRUPTCY ESTATES THROUGHOUT THE UNITED STATES.

Over ninety percent (90%) of all bankruptcy proceedings presently filed nationwide are of a non-business nature, involving over-extended consumers who possess nominal estates. See, Schaeffer, *Proceedings in Bankruptcy in Forma Pauperis*, 69 COLUM. L. REV. 1203, 1210-12 (1969); and Dilenschneider, *Dischargeability: A Brief for the Consumer Bankrupt*, 44 REF. JOUR. 83 (1970). Consequently, questions involving refunds of excess withholdings undoubtedly arise frequently in bankruptcy courts throughout the country.

The decision of the Ninth Circuit in *Riggs v. James*, supra, is a correct, if not obvious, application of *Lines v. Fredericks*. The opinion of the court below to the contrary means that the bankruptcy laws now lack uniform application in a large circuit. Furthermore, the court below suggests that an opinion of the Eighth Circuit which does not even discuss these issues, by implication is also contrary to the rule of the Ninth Circuit. The present division not only causes an important lack of uniformity in the administration of personal bankruptcies, but it also presents difficult problems of administration for those courts without a Circuit decision.

In *Lines*, this Court summarily affirmed the judgment of the Ninth Circuit. In this case summary disposition reversing the court below and adopting the rule of the Ninth Circuit would be appropriate. Such a decision would not only achieve the constitutional goal of uniform administration of bankruptcy estates, but it would also promote the goal of the CCPA as stated in its preamble. 15 U.S.C. §1671(a).

III

CONCLUSION

For the reasons stated above *amici* urge the Court to grant the petition for writ of certiorari and summarily reverse the judgment of the court below and adopt the rule promulgated by the Ninth Circuit in *Riggs v. James*, 470 F.2d 996 (9th Cir. 1972).

Dated, 16 August 1973.

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